

THE EDUCATION MENU

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Choices, Choices & More Choices
National Society of Tax Professionals

NSTP

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Rule of 24

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Assumption 1

- College tuition is going up
- Many colleges are adding “pay as you use” fees



Assumption 2

- It is never too early to begin the process of “saving for college.”



Assumption 3

- Reviewing the Education Menu with new and existing clients provides a special opportunity to 1) expand one's tax practice and 2) provide a meaningful service to your clients.



Assumption 4

- It's not just Mom and Dad any more.
- The Education Menu offers options to a variety of individuals.



Assumption 5

- Selecting one item from the Education Menu doesn't necessarily exclude other items.
- There are choices, choices and more choices.



The Menu

- Coverdell Education Savings Accounts
- Deduction for Elementary & High School Educators
- Employer-Provided Educational Assistance
- Tuition and Fees Deduction
- Hope Credit
- Lifetime Learning Credit
- 529 Plans
- Student Loan Interest Deduction
- Withdrawals from IRAs



Publication 970

- IRS Publication 970 offers an excellent review and analysis of the Tax Benefits for Education.



Historical Note

- Taxpayer Relief Act of 1997
- The Economic Growth and Tax Relief Reconciliation Act of 2001.
 - The 2001 Act is scheduled to “sunset” on December 31, 2010.



COVERDELL EDUCATION SAVINGS ACCOUNTS

- FORMERLY EDUCATION IRAs.
- THE *ANNUAL* TAX-DEFERRED CONTRIBUTION LIMIT IS
\$2,000 (EFFECTIVE 2002) PER BENEFICIARY PER YEAR.
- DO THEY MAKE SENSE?



CESAs

Generous AGI Test

- THE **AGI** ELIGIBILITY TEST:
 - MARRIED COUPLE:
\$190,000-\$220,000
 - SINGLE TAXPAYER:
\$95,000-\$110,000



Contribution Deadline

- The Final Date on which contributions can be made has been extended to the due date of the return (not including extensions).
 - April 15



CESAs

“Qualified” Expenses

- “QUALIFIED” EDUCATION EXPENSES HAVE BEEN EXPANDED TO INCLUDE CERTAIN *ELEMENTARY AND SECONDARY* EDUCATION EXPENSES.
- THE EXPENSES CAN BE PAID TO PRIVATE AND RELIGIOUS SCHOOLS.
 - **NOT HOME SCHOOLING**



CESAs

"Qualified" Expenses

- "QUALIFIED" EDUCATION EXPENSES:
 - TUITION
 - FEES
 - BOOKS, SUPPLIES
 - EQUIPMENT
 - ROOM AND BOARD (MUST BE IN SCHOOL AT LEAST HALF TIME)*
- *THERE ARE LIMITS REGARDING THE
EXPENSE FOR ROOM AND BOARD**



CESAs

Account Balance

- **CONTRIBUTIONS** TO A COVERDELL ESA ARE PERMITTED UNTIL THE CHILD REACHES AGE **18**. **\$36,000**
- AMOUNTS REMAINING IN THE ACCOUNT AT **AGE 30** MUST BE WITHDRAWN OR THE ACCOUNT WILL BE SUBJECT TO TAXES AND A 10% PENALTY UNLESS THE ACCOUNT IS ROLLED OVER FOR THE BENEFIT OF ANOTHER FAMILY MEMBER.



Exception for “Special Needs” Beneficiary

- Contributions can be made after his/her 18th birthday.
- Assets can remain in an account after the beneficiary reaches age 30.



Planning Tip

- Taxpayers can claim the Hope or Lifetime Learning credit in a year in which they take a tax-free withdrawal from a CESA.
- Note: You cannot take a tax credit for expenses paid with CESA funds.



Planning Tip

- Taxpayers can contribute to a CESA and a 529 Plan in the same year and for the same beneficiary.



DEDUCTION FOR EDUCATORS

2005 Update

- DURING 2002-2005, EDUCATORS ARE ELIGIBLE FOR AN "ABOVE-THE-LINE" DEDUCTION OF UP TO **\$250** A YEAR FOR THE COST OF BOOKS, SUPPLIES, COMPUTER EQUIPMENT, SOFTWARE, ETC.
- 900 HOUR TEST.
- **NOT FOR HOME SCHOOLING**



Educator's Deduction

- Teachers
- Aides
- Principals
- Counselors



EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

- UP TO **\$5,250** OF EMPLOYER-PROVIDED EDUCATION ASSISTANCE BENEFITS PER YEAR ARE EXCLUDED FROM INCOME.
- THE FUNDS MAY BE USED FOR BOTH UNDERGRADUATE AND GRADUATE-LEVEL COURSES (tuition, fees, books and supplies).

Code Section 127



TUITION & FEES DEDUCTION

- FOR TAX YEARS **2002-2005** TAXPAYERS MAY BE ELIGIBLE TO DEDUCT THE COST OF TUITION AND FEES FOR THEMSELVES, THEIR SPOUSES OR DEPENDENTS.
- USE THE HOPE/LIFETIME DEFINITION OF "QUALIFIED" EXPENSES.
- THIS DEDUCTION IS "ABOVE-THE-LINE."



What Expenses Qualify?

- The “deductible” expenses are defined in the same manner as they are for purposes of the Hope Credit and the Lifetime Learning Credit.



TUITION & FEES DEDUCTION

2004 & 2005: \$4,000

- IN **2002 & 2003**, TAXPAYERS WITH AGI UP TO **\$65,000** (SINGLE) AND **\$130,000** (JOINT) MAY DEDUCT UP TO **\$3,000** IN HIGHER EDUCATION EXPENSES.
- IN **2004 AND 2005**, THE MAXIMUM DEDUCTION GOES UP TO **\$4,000**.
- THE DEDUCTION EXPIRES AFTER **2005**.



TUITION & FEES DEDUCTION

2004 & 2005: \$2,000

- IN **2004 & 2005**, SINGLE TAXPAYERS WITH AGI $>$ \$65,000 BUT \leq \$80,000 ARE ELIGIBLE FOR A **\$2,000** DEDUCTION.
- IN **2004 & 2005**, MARRIED TAXPAYERS FILING JOINTLY WITH AGI $>$ \$130,000 BUT \leq \$160,000 ARE ELIGIBLE FOR A **\$2,000** DEDUCTION.



DEDUCTION ALERT

Deduction or Credit?

- If you take the above-the-line deduction you cannot take either the HOPE or Lifetime Learning credits using the same expenses.
- Choose between the deduction and the credit. A credit generally provides a larger tax savings.



The Credits

Hope and Lifetime Learning

- Non-Refundable Credits
- Form 8863
- Schools Use Form 1098-T



HOPE & LIFETIME LEARNING CREDITS

	<u>2005</u>	<u>2004</u>
Married Filing Jointly	\$87-107	\$85-105
Single	\$43-53	\$42-52
Married Filing Separate	no credit is available	



CREDITS ALERT

- TAXPAYERS CAN CLAIM A TAX CREDIT IN THE SAME YEAR IN WHICH THEY RECEIVE A DISTRIBUTION FROM EITHER A COVERDELL ESA OR A QUALIFIED TUITION PROGRAM (QTP).
- TAXPAYERS CANNOT USE EXPENSES PAID WITH A DISTRIBUTION FROM EITHER A COVERDELL ESA OR A 529 PLAN AS THE BASIS FOR THE EDUCATION CREDITS.



HOPE CREDIT

- \$1,500 NON-REFUNDABLE CREDIT PER **STUDENT**
- AVAILABLE ONLY FOR THE FIRST TWO YEARS OF POST-SECONDARY EDUCATION
- STUDENT MUST BE ENROLLED AT LEAST HALF-TIME
- STUDENT MUST BE PURSUING A DEGREE OR CREDENTIAL



HOPE CREDIT

- THE FOLLOWING EXPENSES WILL QUALIFY FOR THE HOPE CREDIT:
 - TUITION
 - FEES
 - STUDENT ACTIVITY FEES*
 - COSTS FOR BOOKS, SUPPLIES*
 - EQUIPMENT*

***MUST BE PAID TO THE INSTITUTION AS A
CONDITION OF ENROLLMENT**



LIFETIME LEARNING CREDIT

- THE LIFETIME LEARNING CREDIT IS **PER TAX RETURN** AND **NOT** PER INDIVIDUAL.
- THE LIFETIME LEARNING CREDIT IS AVAILABLE FOR **ALL** YEARS OF POSTSECONDARY EDUCATION.
- THE LIFETIME LEARNING CREDIT DOES **NOT** REQUIRE THAT THE STUDENT BE PURSUING A DEGREE OR ENROLLED AT LEAST HALF-TIME.



LIFETIME LEARNING CREDIT 2005

- BEGINNING IN **2003**, EXPENSES OF UP TO **\$10,000** CAN QUALIFY FOR THE LIFETIME LEARNING CREDIT

20% x \$10,000 = **\$2,000** PER TAX RETURN



Did You Know

- If the student is claimed as a dependent on the parents' tax return, only the parent can claim the credit.
- When the parent/s claim the credit, any eligible college expenses paid by the child during the year are treated as if paid by the parent.



529 Plans

One of the Most Valuable Tools?

- PREPAID TUITION
 - **LOCK IN
TOMORROW'S
TUITION AT
TODAY'S PRICES**
- COLLEGE SAVINGS
 - **POTENTIAL RISK
& REWARD**



Historical Note

- 529 Plans were substantially liberalized by the Economic Growth and Tax Relief Reconciliation Act of 2001.



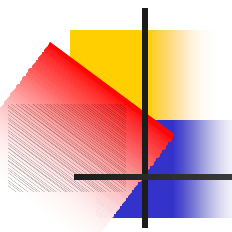
529 Plans Everyone is Eligible

- NO AGI TEST ASSOCIATED WITH 529 PLANS.
- CLIENTS NEED TO BE AWARE OF EXPENSES, RISKS AND REWARDS.



Consider the Possibilities

- Taxpayer/s can combine up to 5 years of gift giving.
- There are no Gift Tax implications on gifts of up to \$55,000/\$110,000.
- 529 Plans allow significant account balances. [Note: State law controls]
- Death of the donor within the 5 years causes estate tax issues.



529 Plans

The Tax Benefit

- A DISTRIBUTION FROM A QTP ESTABLISHED AND MAINTAINED BY A STATE CAN BE EXCLUDED FROM INCOME IF THE AMOUNT IS USED FOR QUALIFIED HIGHER EDUCATION EXPENSES, INCLUDING TUITION AND ROOM & BOARD.



No Need To Stay Home

- While 529 Plan contributors are not limited to participating in a plan offered in their state ... there may be state tax benefits for staying home.



Private Colleges

- Effective 2002, taxpayers can make qualifying contributions to 529 Plans established and maintained by non-state educational institutions.



Independent College Plan

- Effective September 2003, TIAA CREF established a college savings plan for private colleges/universities.

STUDENT LOAN INTEREST DEDUCTION

2005 Update

\$2,500 above-the-line

■ AGI TEST

JOINT: \$105,000-\$135,000

SINGLE: \$ 50,000-\$ 65,000

MARRIED/

FILING SEPARATE: No Deduction



WITHDRAWALS FROM IRAs

- WITHDRAWALS MAY BE MADE FROM A *TRADITIONAL* OR *ROTH* IRA FOR “QUALIFIED” HIGHER EDUCATION EXPENSES WITHOUT HAVING TO PAY THE **10%** EARLY WITHDRAWAL PENALTY.
see 72(t)(2)(E)
- “QUALIFIED” INCLUDES: tuition, fees, books, supplies, equipment and room & board (if student enrolled at least half-time).
- TAX PAID ON THE AMOUNT OF THE EARLY WITHDRAWAL.



WITHDRAWALS FROM IRAs

Continued

- QUALIFIED HIGHER EDUCATION EXPENSES INCLUDE:
 - TUITION
 - FEES
 - BOOKS
 - SUPPLIES
 - EQUIPMENT
 - ROOM & BOARD (IF STUDENT IS ENROLLED AT LEAST HALF TIME)



Thank You

- Thank you for participating in today's Education Menu Seminar.
- Visit www.NSTP.org for a copy of this presentation.
 - Tom Cooke, Executive Director, NSTP